

Portability – much ado about nothing?

BY PATRICIA R. BEAUREGARD

Portability of the federal estate-tax exemption was enacted as part of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. Portability permits a surviving spouse to utilize the predeceased spouse's unused federal exemption. The primary reason for the enactment of the legislation was to eliminate the need for couples to engage in tax planning involving trusts and the reallocation of assets between them.

For the years 2011 and 2012, the federal estate-tax exemption is \$5 million with a top tax rate of 35 percent. Unless new legislation is enacted, the law will revert to an exemption of \$1 million with a top tax rate of 55 percent in 2013. Connecticut has an estate-tax exemption of \$2 million with a top tax rate of 12 percent.

In a typical estate plan for a married couple, attorneys may establish what is known as a credit shelter trust. The purpose is to capture the federal estate-tax exemption of the first spouse to die to hold assets equal to that amount in a trust. The trust assets are available during the surviving spouse's lifetime and any assets remaining at his or her death will pass to the children federal estate tax-free.

While the assets could also pass tax-free to the surviving spouse by utilizing the marital deduction, the result is tax deferral not tax elimination. The surviving spouse's gross estate would then include his or her assets as well as the predeceased

spouse's assets but have the use of only one federal estate-tax exemption. By using a credit shelter trust, the couple utilizes both spouses' exemptions and doubles the amount that can pass federal estate tax-free.

So does portability eliminate the need to do tax planning? In some cases, yes. However, it may lead people to believe they do not need to engage in estate and tax planning when in fact there are both tax and non-tax reasons for doing so. Here are some factors to consider:

Portability does not apply to the Connecticut (or any state) estate tax. Therefore, if you rely on portability, the surviving spouse's estate will be able to utilize only one Connecticut estate-tax exemption and will likely pay more in state taxes at the surviving spouse's death.

Portability does not apply to the federal generation-skipping transfer (GST) tax exemption. GST tax is imposed on transfers to persons two generations or more below the donor. The current exemption is \$5 million. An estate plan may include creditor protection trusts or dynasty trusts for descendants for which the GST exemption is crucial. If the deceased spouse's GST exemption is not utilized at his or her death, it is lost forever.

Portability is available only if both spouses die during 2011 and 2012. While



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the legislation may be extended, there is no guarantee that it will.

Portability applies only to the exemption of your last deceased spouse, so it will be lost if you remarry and your new spouse predeceases you. If your new predeceased spouse made large gifts during his or her life and has little or no exemption remaining, you will have lost the opportunity to use the exemption you were counting on from your first spouse to transfer assets tax-free to your children.

Without a credit shelter trust, the surviving spouse misses the opportunity to shield the appreciation earned on the assets that would have been in that trust at the second death. For example, the \$5 million you would have put in the trust could appreciate to \$8 million. That additional \$3 million would have also passed estate tax-free had it been sheltered in a trust. The result is that overall estate taxes payable at the second death will likely be higher.

With a credit shelter trust, you can ensure that your children will receive the trust assets when your spouse dies. If you rely on portability and your surviving spouse remarries, your spouse would be free to give those assets to his or her new spouse and bypass your children.

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